STATEMENT OF RICHARD S. FULD, JR.
BEFORE THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

APRIL 20, 2010

Mr. Chairman, Ranking Member Bachus, and Members of the House Committee on Financial Services, you have invited me here today to address a number of public policy issues raised by the Lehman Brothers bankruptcy report filed by the Examiner.

Since September of 2008, I have given much thought to the financial crisis and the perfect storm of events that forced Lehman into bankruptcy. Everyone's focus is now on how to prevent another crisis. The key is how regulation and governance should be deployed going forward to better protect the financial markets and the entire system.

The idea of a "super regulator" that monitors the financial markets for systemic risk, I believe, is a good one. To be successful in today's challenging environment, this new regulator should have actual experience and a true understanding of the business of financial institutions, the capital markets and risk management and must be given the resources sufficient to accomplish its important mission.

My view is that the new regulator also should have access, on a real-time basis, to all information and data regarding transactions, assets and liabilities, as well as current and future commitments. In addition, we should put in place established and effective methods of communication between the regulator and the firms being regulated, all of whom should be guided by clear standards for capital requirements, liquidity and other risk management metrics.

The job of the new regulator can only be done, in my opinion, with the creation and utilization of a master mark-to-market capability that determines valuations and capital haircuts on all assets, commitments, loans and structures.

In short, to have a fair and orderly market, I believe we need a single set of transparent rules for all of the participants.

You have asked specifically about the role of the SEC and the Federal Reserve Bank of New York. Beginning in March of 2008, the SEC and the Fed conducted regular, at times daily, oversight of Lehman. SEC and Fed officials were physically present in our offices monitoring our daily activities. The SEC and the Fed saw what we saw, in real time, as they reviewed our liquidity, funding, capital, risk management and mark-to-market processes. The SEC and the Fed were privy to everything as it was happening. I am not aware that any data was ever withheld from them, or that either of them ever asked for any information that was not promptly provided.

After an extended investigation into Lehman's bankruptcy, the Examiner recently published a lengthy report stating his views. Despite popular and press misconceptions about Lehman's valuations of mortgage and real estate assets, liquidity, and risk management, the Examiner found no breach of duty by anyone at Lehman with respect to any of these.

Speaking of asset valuations, the world still is being told that Lehman had a huge capital hole. It did not. The Examiner concluded that Lehman's valuations were reasonable, with a net immaterial variation of between $500 million and $2.0 billion. Using the Examiner's analysis, as of August 31, 2008 Lehman therefore had a remaining equity base of at least $26 billion. That conclusion is totally inconsistent with the capital hole arguments that were used by many to undermine Lehman's bid for support on that fateful weekend of September 12, 2008.

The Examiner did take issue, though, with Lehman's "Repo 105" sale transactions.

As to that, I believe that the Examiner's report distorted the relevant facts, and the press, in turn, distorted the Examiner's report. The result is that Lehman and its people have been unfairly vilified.

Let me start by saying that I have absolutely no recollection whatsoever of hearing anything about Repo 105 transactions while I was CEO of Lehman. Nor do I have any recollection of seeing documents that related to Repo 105 transactions. The first time I recall ever hearing the term "Repo 105" was a year after the bankruptcy filing, in connection with questions raised by the Examiner.

My knowledge, therefore, about Lehman's Repo 105 transactions, and what I will say about them today, is based upon my understanding of what I have recently learned.

As CEO, I oversaw a global organization of more than 28,000 people with hundreds of business lines and products and with operations in more than forty countries spread over five continents. My responsibility as the CEO was to create an infrastructure of people, systems and processes, all designed to ensure that the firm's business was properly conducted in compliance with the applicable standards, rules and regulations.

There has been a lot of misinformation about Repo 105. Among the worst were the completely erroneous reports on the front pages of major newspapers claiming that Lehman used Repo 105 transactions to remove toxic assets from its balance sheet. That simply was not true. According to the Examiner, virtually all of the Repo 105 transactions involved highly liquid investment grade securities, most of them government securities. Some of the newspapers that got it wrong were fair-minded enough to print a correction.

Another piece of misinformation was that Repo 105 transactions were used to hide Lehman's assets. That also was not true. Repo 105 transactions were sales, as mandated by the accounting rule, FAS 140.

Another misperception was that the Repo 105 transactions contributed to Lehman's bankruptcy. That was not true either. Lehman was forced into bankruptcy amid one of the most turbulent periods in our economic history, which culminated in a catastrophic crisis of confidence and a run on the bank. That crisis almost brought down a large number of other financial institutions, but those institutions were saved because of government support in the form of additional capital and fundamental changes to the rules and regulations governing banks and investment banks.

The Examiner himself acknowledged that the Repo 105 transactions were not inherently improper and that Lehman vetted those transactions with its outside auditor. He also does not dispute that Lehman appropriately accounted for those transactions as required by Generally Accepted Accounting Principles.

I have recently learned that, in 2000, the Financial Accounting Standards Board published detailed accounting rules for transactions of this very type, described them and dictated how they should be accounted for. In 2001, Lehman adopted a written accounting policy for Repo 105 transactions that incorporated those accounting rules. E&Y, the firm's independent outside auditor, reviewed that policy and supported the firm's approach and application of the relevant rule, FAS 140.

As I now understand it, because Lehman's Repo 105 transactions met the FAS 140 requirements, that accounting rule <u>mandated</u> that those transactions be accounted for as a sale. That was exactly what I believe Lehman did. Lehman should not be criticized for complying with the applicable accounting standards.

In other words, those transactions were modeled on FAS 140. The accounting authorities wrote the rule that expressly provided for those transactions and how they should be accounted for. To the best of my knowledge, Lehman followed those rules and requirements.

My job as the CEO was also to put in place a robust process to ensure that Lehman complied with all of its obligations to make accurate public disclosures. I had hundreds of people in the internal audit, finance, risk management and legal functions to ensure that we did, in fact, comply with all of our obligations.

Part of that process was E&Y's role in auditing our financial statements and reviewing our quarterly and annual SEC filings. Each year, E&Y issued formal opinions that Lehman's audited financial statements were fairly presented in accordance with GAAP, and they were.

We also had in place a rigorous certification process that was carried out in advance of every annual and quarterly SEC filing. That bottom-up process involved hundreds of people who had first-hand knowledge of the firm's day-today business and the responsibility to review for accuracy and compliance the firm's SEC disclosures before they were filed.

Before we made any annual or quarterly filing, the key people who were involved in this process signed certifications confirming that, to their knowledge, the filing did not contain any untrue statement of a material fact or any material omission and that it fairly presented Lehman's financial position.

Our certification process culminated, every quarter, with a mandatory, all-hands, in-person meeting, which was chaired by Lehman's Chief Legal Officer. In addition to me, that meeting was attended by the firm's President, Chief Financial Officer, Financial Controller, Executive Committee members, business heads, the principal internal audit, finance and risk managers, legal counsel and our outside auditors.

After we had reviewed the draft annual or quarterly filing in detail, the Chief Legal Officer and I would each ask everyone present to speak up if there was anything in the document that caused them concern, or if anything had been omitted that they thought should be included. Attendees were also told that they should speak separately with the Chief Legal Officer if they had an issue that they did not want to raise at the meeting. To my knowledge, no one ever, at any of those meetings, raised any issue about Repo 105 transactions.

I relied on this certification process because it showed that those with granular knowledge believed the SEC filings were complete and accurate. I never signed an SEC filing unless it was first approved by the Chief Legal Officer.

Mr. Chairman, I thank you for allowing me to speak on these issues and I will be pleased to answer any questions this Committee may have.